

## Internal Revenue Service

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Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:  
CC:PSI:B04  
PLR-131262-13

Date:  
January 23, 2014

### Legend

Decedent	=
Will	=
Trust	=
Company	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Year 1	=
Settlement Agreement	=

Child	=
Grandchild 1	=
Grandchild 2	=
Grandchild 3	=
Grandchild 4	=
Grandchild 5	=
Grandchild 6	=
Grandchild 7	=
Grandchild 8	=
Grandchild 9	=
Grandchild 10	=
Trust of Grandchild 11	=
Great-grandchild 1	=
Great-grandchild 2	=

Great-grandchild 3	=
Great-grandchild 4	=
Great-grandchild 5	=
Great-grandchild 6	=
Great-grandchild 7	=
Great-grandchild 8	=
Great-grandchild 9	=
Great-grandchild 10	=
Great-grandchild 11	=
Great-grandchild 12	=
Estate of	
Great-grandchild 13	=
Individual Trustees	=
Bank	=
Court	=
Court Order	=
State	=
State Statute	=
Citation	=

Dear :

This letter responds to your authorized representative's letter dated July 11, 2013, requesting rulings on the income, gift and generation-skipping transfer (GST) tax consequences of the proposed termination of trust pursuant to a court-approved settlement agreement.

The facts and representations submitted are summarized as follows:

Decedent died on Date 1, a date prior to September 25, 1985. Decedent's Will established a testamentary trust (Trust) for the benefit of Decedent's relatives, spouse and issue. Trust was originally funded primarily with stock of Company. Individual Trustees and Bank serve as trustees (Trustees).

The terms of Will are as follows:

Paragraph 24 provides that the residue of Decedent's estate is to be held in Trust.

Paragraph 28 provides that at the death of Decedent's spouse, the net income from Trust will be divided and paid in equal portions to each of Decedent's children, or to the surviving

issue of any deceased child, during the lifetime of the longest lived of said children.

Paragraph 30 provides that at the death of the last survivor of Decedent's children and spouse, the trust will terminate and the principal will be divided, distributed and paid, share and share alike, to all of Decedent's grandchildren then living.

Currently, Child, the last surviving child of Decedent, eleven Grandchildren and thirteen Great-grandchildren are the qualified beneficiaries of Trust. Qualified beneficiary is defined under State Statute.

Trust has been the subject of litigation for many years. On Date 2, Child filed a petition with Court requesting that Trust be terminated and the petition contained a request for payouts to beneficiaries of Trust. The petition led to a succession of discussions, negotiations and pleadings among certain of the beneficiaries. A counter-petition to dissolve Trust was filed by Great-grandchild 1 and Great-grandchild 2 on Date 3, requesting differing payouts from Trust. The counter-petition drew a response from Trustees. Trustees' response and all of the petitions were subsequently withdrawn in favor of negotiations among the petitioner, counter-petitioners, and Decedent's grandchildren.

On Date 4, Court determined that the purpose of Trust had been fulfilled and that Court may terminate Trust upon agreement of all of the qualified beneficiaries (as defined in State Statute) of Trust and entered an order to that effect. See, Citation. The negotiations among Trust beneficiaries led to a settlement agreement (Settlement Agreement) signed by all of Trust's qualified beneficiaries on Date 5. Court entered Court Order terminating Trust in accordance with the Settlement Agreement on Date 6.

The terms of Settlement Agreement are as follows:

Trust will terminate and each income beneficiary who is not also a remainder beneficiary will receive a distribution representing the actuarial value of such income beneficiary's interest in Trust.

Until the termination date, Trustees will make distributions to Trust beneficiaries in accordance with the terms of Trust.

Upon Trust termination, Trustees will make cash distributions to certain beneficiaries of Trust as prescribed in Settlement Agreement.

Following the cash distributions, Trustees of Trust will distribute the shares of stock of Company and any other property in-kind in equal shares to other beneficiaries.

It is represented that no additions (constructive or actual) have been made to Trust since Date 1.

You have requested the following rulings:

1. The contemplated termination distributions to Decedent's Grandchildren will not cause the grandchildren to recognize income on termination of Trust pursuant to Court Order except to the extent the distributions carry out distributable net income.
2. Terminating distributions pursuant to Court Order will not cause Trust to become subject to GST Tax, and no such distribution will be a direct skip, a taxable distribution or a taxable termination with the meaning of § 2612 of the Internal Revenue Code.
3. Termination distributions pursuant to the Court Order will not result in a taxable gift.
4. On termination of Trust pursuant to Court Order, each recipient of a termination distribution for a cash distributee will recognize capital gain in the amount of his or her distribution.

#### Ruling 1

The Service has declined to rule on this issue

#### Ruling 2

Section 2601 imposes a tax on every generation-skipping transfer made after October 22, 1986.

Section 2611(a) provides that the term "generation-skipping transfer" means a tax distribution, a taxable termination, and a direct skip.

Under § 1433 of the Tax Reform Act of 1986 (the Act), the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, except to the extent the transfer is made out of corpus added to the trust by an actual or constructive addition after September 25, 1985.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(B) provides that a court-approved settlement of a bona fide issue regarding the administration of the trust or the construction of terms of the governing instrument will not cause an exempt trust to be subject to the provisions of chapter 13, if -- (1) the settlement is the product of arm's length negotiations; and (2) the settlement is within the range of reasonable outcomes under the governing instrument and applicable state law addressing the issues resolved by the settlement. A settlement that results in a compromise between the positions of the litigating parties and reflects the parties' assessments of the relative strengths of their positions is a settlement that is within the range of reasonable outcomes.

Section 2612(a)(1) defines the term "taxable termination" as the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in a trust unless -- (A) immediately after the termination, a non-skip person has an interest in the property, or (B) at no time after the termination may a distribution (including distributions on termination) be made from the trust to a skip person. Section 2612(b) defines the term "taxable distribution" as any distribution from a trust to a skip person (other than a taxable termination or a direct skip). Section 2612(c)(1) defines the term "direct skip" as a transfer subject to the federal estate and gift tax of an interest in property to a skip person.

In this case, based upon the facts submitted and the representations made, we conclude that Trust is exempt from GST tax because Trust was irrevocable prior to September 25, 1985 and it is represented that no additions (constructive or actual) have been made to Trust.

In addition, the facts submitted and representations made indicate that the termination of Trust pursuant to Settlement Agreement and Court Order represents a compromise between the positions of the litigating parties and reflects the parties' assessments of the relative strengths of their positions. These facts and representations indicate that the settlement is the product of arm's length negotiations and is within the range of reasonable outcomes under Trust's terms and applicable State law. In addition, the termination of Trust accelerates the distributions to all of the qualified Trust beneficiaries

Accordingly, based upon the facts submitted and the representations made, we conclude that terminating distributions pursuant to Court Order will not cause Trust to become subject to GST Tax, and no such distribution will be a direct skip, a taxable distribution or a taxable termination within the meaning of § 2612.

### Ruling 3

Section 2501(a) provides that a tax is imposed for each calendar year on the transfer of property by gift during such calendar year.

Section 2511(a) provides that the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(b) of the Gift Tax Regulations provides that, as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him or her no power to change its disposition, whether for his or her own benefit or for the benefit of another, the gift is complete. But, if upon a transfer of property, a donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the fact in the particular case.

Section 25.2511-1(c)(1) provides that any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

Whether an agreement settling a dispute is effective for gift tax purposes depends on whether the settlement is based on a valid enforceable claim asserted by the parties and, to the extent feasible produces an economically fair result. *See Ahmanson Foundation v. U.S.*, 674 F.2d 761, 774-75 (9th Cir. 1981), citing *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967). Thus, state law must be examined to ascertain the legitimacy of each party's claim. If it is determined that each party has a valid claim, the Service must determine that the distribution under the settlement reflects the result that would apply under state law. If there is a difference, it is necessary to consider whether the difference may be justified because of the uncertainty of the result if the question were litigated.

As discussed above, Settlement Agreement represents the resolution of bona fide controversies among the parties. All interested parties who hold or may hold an interest in Trust have been represented in the proceedings that culminated in Court Order approving the Settlement Agreement. Further, based on the facts as presented, the terms of the Settlement Agreement are the product of arm's length negotiations among all the interested parties. We conclude that Settlement Agreement reflects the rights of the parties under the applicable State law that would be applied by the highest court of State

and under federal law. Accordingly, based on the facts submitted and representations made, we rule that the termination distributions from Trust pursuant to Court Order will not result in a gift by any of the beneficiaries.

Ruling 4

The Service has declined to rule on this issue.

In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter to your authorized representatives.

Except as expressly provided herein, we neither express nor imply any opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the Taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

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Lorraine E. Gardner  
Senior Counsel, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures

Copy for § 6110 purposes  
Copy of this letter

cc: